

# Why Arbitration?

by Eugene Bucher

## I. The reasons for concluding arbitration-agreements in general

The following text concerns arbitration-clauses and the various reasons for their being included in contracts of small, medium as well as big size enterprises; obviously no reference is made to agreements as concluded in the private sector by consumers. In the present days the aspects to be considered are practically identical in all developed countries. In addition the MERCOSUR and the actual development in this area invites reference to a different situation in the past and to emphasize the importance of the changes occurred in the last two decades, i.e. the acceptance of arbitration as an instrument to improve the handling of commercial disputes.

### A. Better Justice?

Arbitration, i.e. the settlement of disputes of whatever origin by a small number of persons authorized to decide on controversies of the parties and restore peace and order, has its roots in prehistoric times and existed in all periods known to us; the then involved parties may have been two tribes, princes or private people having opposed claims. Institutionalized tribunals not being the consequence of an existing dispute but created in anticipation with the endeavour to settle those arising in the future, hardly existed before the end of the Middle Ages; mention may be made that in Rome of the Antiquity their famous jurisdiction was realized in a kind of imposed arbitration: The *praetor* as the second-highest official behind the *consul* had in the cases presented to him to circumscribe the legal question inherent to the dispute and to entrust a private person with the task to act as *judex*. No doubt the parties, before asking the *praetor*, did try to agree on the person to judge their case; the *judex* nominated by the *praetor* was the substitute for the arbitrator not agreed on by the parties: Similar procedure as realized today, when in the absence of an agreement of the parties an arbitrator (or the chairman of the group of three arbitrators) is appointed by an authority authorized to do so.

In former days the prevalence of arbitration was the consequence of the absence of institutionalized tribunals as they may have existed in some cities only or been created by some feudal authorities. In our days of generally available state jurisdiction the decision in favour of arbitration is in the first line motivated by the quality-aspect: The persons foreseen as arbitrators may be more experienced in the field concerned, they may reserve more time and interest to the cases as can do judges of state tribunals with their daily workload etc. Aspects of this kind have some statistical weight, but are not necessarily conclusive. More important seems to the author of these lines the aspect of *confidence of the parties*: In arbitration they have the possibility to personally select their judges, totally if they agree on the persons of the arbitrators, and at least partially when they foresee a tribunal of three

arbitrators and can at least nominate one of them, having therefore the hope that the arguments in their favour will be presented in the internal discussion of this body. Often the absence of the not necessarily justified, but wide-spread distrust may be decisive: In international cases the party seeing their case tried in a foreign country may presume that the tribunal will be inclined to decide in favour of the opposed party, their fellow-countryman. It is the privilege of arbitration that it allows to grant absolute symmetry in that respect by selecting the single arbitrator or the president of a group of three from a state other than those of the parties.

## **B. For sure: Through arbitration safer execution**

In most countries the execution of judicial decisions is possible without difficulties and risks as far they are rendered at home, while the opposite is true if the decision to execute has its origin abroad, may it be rendered by arbitral or ordinary courts. The execution of "foreign" judgements or awards requires an explicit legal basis comprising specifically the two countries concerned. Said basis may be a bilateral agreement of the two states concerned, a multiparty convention or a generally applicable statute of the country requested to execute. In the latter cases the *precondition of reciprocity* is very common, which may be doubtful and then possibly oblige the party striving for execution to provide evidence, that the country originating the decision to execute granted in the past execution to decisions originating in the other state: An often difficult endeavour with uncertain result.

Said situation is worldwide still prevalent for judgements of state courts and was in the past on a large scale also reality for arbitral awards. However, on the international level, endeavours to overcome this unacceptable situation started very early; conventions in that respect came into existence. The *Convention on the Execution of Foreign Arbitral Awards* signed in Geneva the 26 of September 1927 (entry in force 25.7.1929) is still in force but had a restricted number of participants only and lost subsequently its importance by the subsequent *New York Convention of the United Nations on the Recognition and Enforcement of Foreign Arbitral Awards* of June 10th 1958 (*Convención sobre el Reconocimiento y la Ejecución de las Sentencias Arbitrales Extranjeras*), which shall be presented in the following (here "NY Convention"). Its importance is fundamental: Facilitating the execution of arbitral awards to the maximum possible, this Convention is actually effective in almost all developed countries of our planet with the consequence of furthering worldwide cooperation and exchange of goods and the there from resulting prosperity.<sup>1</sup>

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<sup>1</sup> The possibility of execution based on the UN Convention is not seriously questioned by its Art. V / 2: "Recognition and enforcement of an arbitral award may also be refused if the competent authority in the country where recognition is sought finds that: ... (b) The recognition or enforcement of the award would be contrary to the public policy of that country". The general practice is presumably reluctant to recur to the vague notion of public policy. The Law on Swiss International Private Law in its Art. 190 sec. 2 par. e allows an appeal against an arbitral award to the Swiss Federal Tribunal under the same condition, a remedy often tried, but without success until today. Such attitude is presumably prevalent worldwide and also in the MERCOSUR. Nevertheless an exception may be mentioned which occurred in an area far away from Latin America: The Philippine Court of Appeal refused to enforce an ICC Tribunal award concerning a turnkey contract governed by Philippine Law about the construction of a power plant (for details see *Asian Dispute Review*, Hong Kong, April 2007, S.71 ss.). This came to the knowledge of the undersigned after the congress while writing these lines.

## II. The NY Convention and its basic principle

1. Core of the NY Convention is its Article III: "Each Contracting State shall recognize arbitral awards as binding and enforce them in accordance with the rules of procedure of the territory where the award is relied upon ... There shall not be imposed substantially more onerous conditions or higher fees or charges on the recognition or enforcement of arbitral awards ... than are imposed on the recognition or enforcement of domestic arbitral awards." In other words: Foreign awards shall be enforced in the same way as they could be enforced in their place of origin, this without impediments or costs going beyond those applied in the country of execution.

2. The NY Convention is focused on the execution and the countries requested to execute; the obligations resulting from this text bind the contracting States as far as they are requested to execute, whilst with respect to the place of origin of the award the Convention does not foresee any obligation (e.g. require cooperation of any sort) and does not establish origin-related preconditions: No preconditions as to the law-systems of the place of origin and first of all no pre-requisite of reciprocity; the state where the award was made may stay outside the NY Convention and miss other rules allowing execution of foreign awards<sup>2</sup>.

3. The state of origin, even left without any obligations and not supposed to allow execution of foreign awards, is of prime importance as to the effect of its application in the state requested to execute: The execution of the award abroad is governed by the preconditions and the effects as existing in the state where the award came into existence: The *validity of the arbitration* clause as signed by the parties to the arbitration, the *capacity* and *authority* of the arbitrators rendering the award, the *formal prerequisites* of the award itself and other possible preconditions of the validity of the award are to be determined according to the rules of the State of origin. The laws of the State of origin have no impact to the execution, i.e. the question whether it can be granted in general and, if so, in which manner, but they decide about the validity of the award and the preconditions of its execution under the rules of the NY Convention. In the present text we cannot consider the different ways to define the preconditions of valid (i.e. executable) awards and the formalities required, but the following question asks for an answer: How to determine the *State of origin*, and what may be called *place of arbitration* or *origin* of the award to be executed, a tricky question not answered by the Convention which simply refers to "arbitral awards *made in the territory* of a State ..." not specifying what aspects are relevant to determine that territory.

## III. How to determine the State of origin of the award

The definition of "place of arbitration" is relevant not only to determine the requirements of valid awards asking for execution: The laws of the place of arbitration decide on two fundamental aspects of the arbitration-procedure: They determine the means available

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<sup>2</sup> Art. I par. 3 opens the possibility to make a reservation restricting the application of the Convention to awards originating in an country granting reciprocity. This provision is without relevance; only few signatories made that reservation, and the ubiquitous adherence to the NY Convention provide ubiquitous reciprocity.

if a party to an arbitrable dispute refuses to nominate an arbitrator, if the parties vs. the party-appointed arbitrators fail to agree on the chairman and other problems of this kind, and secondly, they rule about the control of the arbitral proceedings if any by state courts and about the existence of remedies available against arbitral awards<sup>3</sup>.

To connect arbitral proceedings and awards with localities two ways of thinking are possible: physical or consensual. In former days realities seemed decisive: The place where the parties pleaded before the arbitrators and the latter issued their decision. This concept, realistic in days without railways and modern means of communication, is no longer acceptable (but possibly not yet totally forgotten). *Consensualism* is the only realistic concept: The place of arbitration is defined by the parties in the arbitration clause. In the absence of a provision the parties may make up for it at any later stage; if they fail to do so, the arbitral tribunal will determine their seat, at the latest when rendering the award<sup>4</sup>.

The decision of the parties or a substitute to it makes law: The place selected by them is decisive even when at the given place nothing happened and neither arbitrators nor representatives of the parties ever set foot on the territories of the state of origin of the award, the notion "place" being fictitious only, but nevertheless legally effective.

#### **IV. Problems with public entities as parties**

The bigger the interests and the amounts in dispute involved in international enterprises, the bigger the probability and risk that one of the parties is a public entity, be that a state itself or, more likely, a legal person under private law, but partly or totally owned by a state, province etc. Risk, because that invites the party with a background of public law to invoke the old and well established rule of *state-immunity*, i.e. the rule, that States dare not be submitted to national jurisdiction of another State. This argument is possibly invoked in the arbitral proceedings by the defendant but more likely presented in the proceedings of execution as an exception by the party resulting as debtor in the award. The exception is not typical for arbitration but well known also in ordinary procedure. It is related to the immunity of international Organisations as well as to the rule, that public law of foreign countries is not applicable outside the State issuing it. The range of admission of this exception varies from one state to the other. Only a few remarks on this subject of international public law of wide range are possible here.

##### **A. State immunity**

The principle of the *immunity of states* is generally accepted, but equally accepted the view, that its application is restricted to disputes being the consequence of acts of State *iure imperii*, i.e. sovereign acts ("*hoheitlicher Akt*"). It does not apply to obligations and debts resulting from acting on the free market and contracts concluded in order to purchase goods, construct a power plant, roads or tunnels as private individuals could do. Doing so is called to

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<sup>3</sup> The NY Convention implicitly presupposes such possibility in its Art. V, 1 lit .e.

<sup>4</sup> If the parties agreed on a arbitration institution (International Chamber of commerce or any other) such institution has regularly the competence to decide, if the parties cannot agree.

act *iure gestionis*, and it is obvious that the entering into contracts containing an arbitration clause belongs in the outcome to the second group. Exceptions to that are rare, but not rare is the promoting of such argument.

## **B. Absence of authority to sign arbitration-clauses**

Is the exception of State immunity without chance, another argument will be considered by parties facing claims of big size, and it was in the experience of the undersigned as arbitrator promoted by parties from the Balkan as well as other regions. Said tactic questions not the validity of the contract in general, but that of its arbitration clause: It is admitted that the persons signing the contract were authorized to negotiate the contract and to sign it, but that the entrusted power to contract was only related to the contract in its substantial part, whilst for entering an arbitration clause national legislation requires another act, possibly to be performed by other sections of the bureaucracy or even presupposing sanctioning by parliament or the like. It is obvious, that such arguing has no merits (and had in the cases examined by the undersigned no adequate legal provisions to allow the argument). Even if any normative basis would exist, if it was not mentioned at the time of the signing of the contract and was not made known to the other party, it could hardly constitute a valid exception under Art. V, 1 lit. a of the NY Convention.

## **V. The NY Convention and MERCOSUR**

The above was to show the importance and the enormous benefits provided by the NY Convention which will celebrate its half-century anniversary next year. The following lines may show that in the Spanish speaking area in general and specifically in the MERCOSUR the acceptance of the Convention was delayed, a situation much regretted in all countries inclined to invest and do business in that area.

Said retardation may be shown by some figures: Coming into existence of the NY Convention in the year 1958 and its signing and ratification by many states in the early sixties (1965 or earlier i.e. France, Germany, Japan, Austria, Greece, Norway, Finland, The Netherlands, Switzerland); the USA followed 1973 and the United Kingdom in 1975. For the MERCOSUR: 1962 Ecuador (!), 1975 Chile, 1979 Colombia, in the eighties Uruguay, Peru, Argentina, 1995 Venezuela, Brasilia and Bolivia, 1998 Paraguay. Today the other Latin-speaking countries are without exception participants: Mexico (1971), Costa Rica, El Salvador, Cuba, Panama, Portugal (1995).

In our days the acceptance of arbitration as the prevalent if not only adequate way to deal with commercial disputes is perfect, this concluded from its most important element, i.e. the recognition and execution of the resulting arbitral awards as granted by the New York Convention. In the present years the integration of the MERCOSUR in said tradition is equally perfect, as is shown by the ubiquitous ratification of it. The retardation of arbitration on the international level as shown above was in the view of the author the consequence of feelings against colonialism considering international arbitration as an institution created by the European powers and fearing, that the seat of arbitration would mostly be in Europe. Be

that as it may: The actual situation is perfect and not asking for any improvement. There was good reason to emphasize at the Convention in Lausanne the improvement as reached and the changes as performed, because in the domain of arbitration the public in general is poorly informed. To overcome the once in the past justified reluctance to do business in places without adequate means of dispute-resolution necessitates some efforts and deserves them.

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